White Collar Crime Policy

BY SUSAN E. BRUNE

The SEC's New Cooperation Policy

The Securities and Exchange Commission (SEC) has announced a series of important policy changes as it scrambles to reform itself after the public outcry that followed its having missed the Madoff fraud. The SEC's new policy on cooperation is a key part of that effort. As Robert S. Khuzami, the Director of the SEC's Division of Enforcement, recently put it, the policy has "the potential to be a game-changer for the Enforcement Division."[1]

The policy is modeled on the approach that has long been in use at U.S. Attorneys' Offices across the country. With some exceptions, the Division of Enforcement staff is to be substituted into the role of the U. S. Attorney's Office, negotiating cooperation, non-prosecution and deferred prosecution agreements. The five-member Commission itself is to play more or less the role of the sentencing judge, determining the case outcome by deciding whether reduced charges and penalties are appropriate in recognition of the cooperation.

The policy also draws on the SEC's longer-established approach to company cooperation. That approach, first announced in the SEC's 2001 *Seaboard* Report, set forth the circumstances in which a cooperative company can avoid being charged or can mitigate its punishment.[2] The new policy charts a course for cooperation by individuals and pertains to cooperation by companies. Thus, in addition to signaling a new effort to gain the cooperation of individuals, the policy represents an effort to codify what was in essence common law gleaned from *Seaboard* and the cases that followed involving cooperation by companies.

As in any amnesty or plea bargaining regime, the animating idea behind the cooperation policy is to trade favorable treatment for assistance in making cases. As the SEC Enforcement Manual section announcing the policy acknowledges, there is "some tension" between "the objectives of holding individuals fully accountable for their misconduct and of providing incentives for individuals to cooperate with law enforcement authorities."[3] It will be interesting to see whether, in practice, the SEC's desire to make cases can overcome the imperative to minimize criticism for being lenient (or even reasonable).

It is too soon to tell, but the policy may not change things all that much. No matter what the agency's commitment is to the new policy, there are key differences between SEC matters and criminal cases that may well limit the policy's efficacy.

Criminal vs. Civil

SEC enforcement actions are civil matters, brought in federal district courts or as administrative proceedings. An individual can assert a Fifth Amendment privilege in an SEC matter, but the usual price for doing so is that he or she cannot successfully argue against having civil charges brought and, once they are brought, cannot effectively defend them. Under *Baxter v. Palmigiano*, a case decided by the Supreme Court in 1976, "the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them."[4] As a result, the SEC can prevail with nothing more than relatively slight proof and a defendant's invocation of the Fifth Amendment.

In the criminal system, in obvious contrast, an individual faces no sanction at all for invoking his Fifth Amendment rights. Absent a grant of statutory immunity, an individual can remain silent and thereby deprive the authorities of the information they want. It is against that background that cooperation bargains are struck. The individual has something to trade — information and testimony otherwise protected by the Fifth Amendment — and the prosecutor has something tangible to give in exchange — potentially reduced or eliminated prison time.

When criminal practitioners think of cooperation, therefore, what they think of is a person already under investigation or even indictment who is able to bargain for leniency. But, judging from the new policy on cooperation, the SEC is thinking of someone entirely different: a credible insider who will walk into the SEC voluntarily and spill the beans.

The introductory statement accompanying the policy identifies as key factors in assessing cooperation "whether the individual was the first to report the misconduct to the Commission," "whether the cooperation was provided before he or she had

any knowledge of a pending investigation or related action," and "[w]hether the investigation was initiated based on information or other cooperation provided by the individual."[5] And cooperation credit is more or less defined as coming from providing "non-privileged information that was not requested by the staff or otherwise might not have been discovered."[6]

The SEC says that it does not expect attorney-client or attorney work product privilege waivers as a condition for granting cooperation credit. This is welcome news. However, the policy signals that cooperation that comes involuntarily, for example, via testimony sought by the Commission, will not usually count. That makes perfect sense, given the type of cooperator the SEC hopes to attract — that is, someone coming in from the cold, before any SEC investigation is initiated.

Mr. Khuzami's remarks, made at the press conference when the policy was announced, illuminate that point. As he explained, "The reality is that when you engage in misconduct, you now have to think even harder about the possibility of others coming forward to report to the SEC your secret conversations, your hushed plans, your schemes and deceptions. And for those thinking about cooperating, you should seriously consider contacting the SEC quickly, because the benefits of cooperation are reserved for those whose assistance is both timely and necessary."[7]

As will be discussed below, the analogy between cooperation in the SEC and in the criminal contexts for a person already under SEC investigation is so imperfect as to be hardly an analogy at all. And even for that rare insider possessing key information, facing no actual investigation and nonetheless desiring to cut a deal, the SEC is not ordinarily the right place to start. The SEC policy provides no guarantee against criminal prosecution absent an immunity order, something that the SEC can provide only with the consent of the federal criminal authorities.

Cooperation Agreements

According to the SEC's new policy, cooperation comes in several flavors. First is the full-fledged cooperation agreement. While the concept is familiar to criminal defense practitioners, there are several important differences in the SEC context. These differences make it clear that a person already under investigation is not the prototypical SEC cooperator.

SEC cooperation agreements are to be drawn up from a standard form on the authority of the Director of Enforcement, or those to whom he or she delegates authority.[8] According to the Enforcement Manual, the agreements should "generally" include the following terms: (a) the obligation to cooperate fully, testify truthfully, and appear for interviews and testimony as requested without regard to any jurisdictional limits on the SEC's ordinary authority, (b) the obligation not to commit further violations of the securities laws, and (c) a statute of limitations waiver.

The Commission itself does not sign on to the cooperation agreement. Instead, if the cooperator lives up to the bargain, the Division of Enforcement staff "will bring the assistance provided by the cooperating individual … to the attention of the Commission and other regulatory and law enforcement authorities as requested."[9] Upon written request of the cooperating individual or company, the Division of Enforcement staff agrees to do so by submitting what is analogous to a 5K1.1 letter in a criminal case, detailing the "fact, manner and extent" of the individual's cooperation.[10] To get a promise of a recommendation of a specific settlement of the matter, the individual has to enter into an agreement that includes a requirement that he or she render "substantial assistance," coupled with an undertaking to settle a specific charge or charges on a neither-admit-nor-deny basis.

At first blush, this does not seem unusual. After all, in a criminal case, the sentencing judge does not ordinarily sign on to the cooperation agreement. The difficulty in the SEC context, though, is that there is no well-established tradition under which the Commission rewards cooperation. Certainly, the Commission might now develop such a tradition; after all, the current commissioners issued the policy. But the composition of the Commission changes over time, and so do the political winds. For example, the policy explicitly indicates that more credit will be given if the cooperation relates to a "subject matter" that "is a Commission priority."[11] Whether something is a priority for the Commission is, of course, out of the individual's control. This provides a difficult uncertainty to anyone contemplating cooperation with the SEC. And if, in the future, the word gets out that the Commission has rejected an Enforcement recommendation based on cooperation, that uncertainty will be compounded.

According to the Manual, cooperation agreements are "preferably" to be preceded by a proffer.[12] The SEC enforcement staff has long conferred written proffer agreements, providing that, with certain exceptions, statements made during the proffer will not be used against an individual during subsequent proceedings.[13] The proffer agreements reserve to the SEC the right to share the information provided with the appropriate authorities in prosecutions for perjury, false statements, or obstruction.[14] The SEC may also use the information as a source of leads. And the SEC may use the information provided at a proffer "for impeachment or rebuttal purposes if the person testifies or argues inconsistently in a subsequent proceeding."[15]

The dilemma for those who propose to cooperate is a familiar one. A cooperator is required to be truthful and to cooperate fully, including informing the authorities of conduct about which they would otherwise be unaware. Thus, there is a real prospect that by cooperating — or even attempting to cooperate — an individual can make matters worse by giving information to the authorities that would otherwise be unavailable to them and by limiting the individual's ability to defend himself against any charges. That is a risk that some in the criminal context are willing to run in order to avoid or minimize prison time. But the sanctions that the SEC can impose, while serious, are not as serious as prison time. And the benefits that the SEC can confer do not include eliminated or reduced prison time. As a result, for individuals, the cost-benefit analysis in the SEC context will be quite different from that in the criminal justice system.

It should also be noted that an individual who strikes a cooperation deal with the criminal authorities will not ordinarily also be able to strike one at the SEC. Under the policy, whether the cooperation "was voluntary or required by the terms of an agreement with another law enforcement or regulatory organization" is a key factor for the SEC in determining whether to grant cooperation credit.[16]

On the other hand, it is important to note that when determining whether an individual has been fully

held to account for the underlying conduct, the policy requires the SEC to consider sanctions imposed by other authorities and self regulatory organizations as well as the individual's opportunity to commit future violations in light of his or her occupation.[17] This part of the policy seems to give weight to what defense attorneys often argue, rarely with success, are collateral consequences that justify leniency irrespective of cooperation. By implication, however, consideration of these factors seems to march other decision makers toward ensuring that there are plenty of collateral consequences — in the form of industry bars and delicensure — separate from whatever sanctions the SEC may impose.

Non-Prosecution Agreements

The SEC non-prosecution agreement is, at least at a superficial level, analogous to letter immunity in the criminal context. As with cooperation agreements, the cooperator has to cooperate "truthfully and fully." If the cooperator breaches this obligation or other obligations, such as an obligation to disgorge or pay penalties, the Division of Enforcement can recommend to the Commission that there be an enforcement action, which can be based on the statements, information, and materials provided by the individual as part of the cooperation.

Unlike cooperation agreements, non-prosecution agreements have to be approved by the Commission itself.[18] The Enforcement staff can give "oral assurances," but those assurances must be accompanied by the caution that, while Enforcement "does not anticipate recommending an enforcement action," the Commission "has final authority to accept or reject enforcement recommendations."[19]

Moreover, to receive a non-prosecution agreement, the individual almost invariably will be required to have given a proffer in advance.[20] These requirements mean that the individual usually has to give the Enforcement staff what they want — information — in advance of receiving any benefit or even an agreement to recommend a benefit. And, to the extent that the SEC wants the information again, without whatever limited protections are available under a standard proffer agreement, the SEC need only demand it by subpoena.

For an individual or company, a non-prosecution agreement is usually better than a cooperation agreement requiring settlement of SEC charges. But the same problems remain. The would-be cooperator has to give information to the SEC Enforcement staff before reaching agreement on and receiving Commission approval of the sanction. And an agreement at the SEC does not ensure peace with criminal and other authorities.

Statutory Immunity

The Enforcement staff can obtain statutory immunity for witnesses and can do so in the absence of a proffer.[21] Under "streamlined" procedures set forth in the SEC Manual, the Director of Enforcement and senior officers he or she designates apply to the Department of Justice (DOJ) for the authority to seek a court order granting statutory immunity.[22] In the alternative, after obtaining authority from DOJ, the Commission itself may issue an order compelling testimony or production.[23] The immunity order can cover testimony or can be for act-of-production immunity requiring the production of documents.

Demanding immunity may be a risky approach for an individual not already on the criminal authorities' radar screen. After all, the SEC cannot obtain immunity without first obtaining DOJ's approval. And if there is a real prospect of criminal prosecution, why would an individual call attention to himself or make statements to the SEC in the first place?

Deferred Prosecution Agreements

In deferred prosecution agreements in the criminal context, the prosecution agrees to forgo taking action for a specified period while the statute of limitation is tolled. Usually, deferred prosecution agreements for individuals have a single principal term: that there be no further wrongdoing during the term of the agreement.

Deferred prosecution agreements for companies typically also include various compliance remedies, such as an outside compliance monitor. Either way, without any finding of wrongdoing, deferred prosecution agreements amount to probation, often without any judicial involvement.

In the SEC version, the deferred prosecution agreement concept is married to cooperation. In addition to promising not to engage in violations of law during the deferral period not to exceed five years and complying with other unspecified "undertakings" — including, presumably in the case of a company, accepting compliance remedies — the cooperator has to "cooperate truthfully and fully."[24] The cooperator also can be required to "make good" on any agreed-upon disgorgement and penalty amounts.[25] There can also be a provision for an agreed-upon remedy if there is a breach of the deferred prosecution agreement, in the form of an agreement by the company or individual to admit, or at least not to contest, facts that the Commission can use to bring a case.[26]

In the criminal context, deferred prosecution agreements have been a mechanism for bringing about corporate "culture change," particularly through the imposition of outside monitors and other enhanced compliance measures. When used in this way, deferred prosecution agreements can be valuable tools for the prosecution and for the defense. For a corporation, the same should be true at the SEC.

For the individual, the deferred prosecution mechanism likewise provides a zone for flexibility. A deferred prosecution agreement might be particularly appropriate for someone with compelling personal circumstances, and its availability at the SEC is a change to be welcomed.

What Will the Policy Mean in Practice?

The availability of the SEC's increasingly user-friendly Web site and extensive press coverage of the SEC's doings means that the general public has access, as never before, to information about its decisions. With public access to information comes criticism. And, in the current age, the most common criticism is that government in general and the SEC in particular are "too soft" on Wall Street.

Some of the most useful cooperators in the criminal system have been those individuals most deeply enmeshed in criminal schemes. Those who are less culpable often have less to trade. Thus, for the SEC cooperation regime to work to its advantage, the agency has to make unpopular deals — and live up to them. There are reasons to doubt that the SEC has the institutional will to do that or even that the Commission will abide by whatever the Enforcement staff recommends.

The policy on cooperation sets forth a long list of factors to be taken into account in assessing cooperation. Under the policy, there are 10 considerations in the category "assistance

provided by the individual."[27] Most of these factors are exactly what one would expect, e.g., the timeliness of the cooperation, the quality of the cooperation, whether the cooperation resulted in "substantial assistance,"[28] and so on. Another set of factors relates to the "profile of the individual," which is further defined as the individual's "history of lawfulness," the degree to which the individual has shown "acceptance of responsibility,"[29] and the "degree to which the individual will have an opportunity to commit future violations."[30] On the other side of the ledger are the considerations that are to inform the Commission in weighing the public interest "in holding the individual accountable," such as the "severity of the individual's misconduct," the "culpability of the individual," and the "degree to which the individual tolerated" the misconduct.[31]

The upshot of having so many factors will be that it could be nigh close to impossible to use them to predict when cooperation credit will be given. If there remains any doubt that the Commission retains almost unlimited discretion, a note accompanying the policy sets it to rest. According to the note, the factors "are not listed in order of importance nor are they intended to be all inclusive or to require a specific determination in any particular case. Further, depending upon the facts and circumstances of each case, some of the principles may not be applicable or may deserve greater weight than others."[32] Nothing in the policy "creates or recognizes any legally enforceable rights for any person."[33]

It will be interesting to see what the policy means in practice, though in truth it may be hard to know. The new cooperation policy is set out in the January 2010 version of the SEC Division of Enforcement's Enforcement Manual. It is worth noting that the Manual was first publicly available on the SEC's Web site in October 2008. The publication of the Manual was a significant step toward transparency, something only fitting for an agency that has historically made it a prime mission to force disclosure. However, the Manual provides for only a modicum of transparency as to who is getting credit for what cooperation. It does not appear that the Division of Enforcement's letter recommendations to the Commission will be released publicly. Instead, that cooperation has led up to a settlement is supposed to be recited only in standard language in the offers or consents to settlement.[34] Even this boilerplate standard disclosure language may be omitted, at Enforcement's discretion.[35]

For the reasons discussed above, it looks like individual cooperation — where an individual already under investigation is credited for providing information — could be rare. What could become more frequent is a situation in which SEC enforcement lawyers seek additional sanctions against individuals whom they criticized for having failed to "cooperate," that is, against those who defend. As many have observed, such appears already to have been the case for companies beginning at least with *Seaboard*. If the same thing happens for individuals, it will hardly be fair, given that the policy makes it unlikely that individuals already under investigation will receive credit for cooperation.

Notes

1. Robert S. Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission, Remarks at News Conference Announcing Enforcement Cooperation Initiative and New Senior Leaders, at 1 (Jan. 13, 2010) *available at* www.sec.gov/new/speech/2010/spch011310rsk.htm.

2. *See* Press Release, Securities and Exchange Commission, SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations (Jan. 6, 2010), *available at* http://www.sec.gov/news/press/2010/2010-6.htm. *See also* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44969, Accounting and Auditing Enforcement Release No. 1470 (Oct. 23. 2001), *available at* http://www.sec.gov/litigation/investreport/34-44969.htm.

3. SEC Division of Enforcement, Enforcement Manual, § 6.1.1 at 123 (17 C.F.R. § 202.12) (Jan. 13, 2010, including conforming revisions as of Mar. 3, 2010) (the "Manual"), *available at* www. http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

4. *Baxter v. Palmigiano,* 425 U.S. 308, 318 (1976).

5. Manual, § 6.1.1 at 124 (17 C.F.R. § 202.12(a)(1)(ii)-(iii)).

6. Manual, § 6.1.1 at 124 (17 C.F.R. § 202.12(a)(2)(ii)).

7. Khuzami, *supra* note 1, at 3.

8. Manual, § 6.2.2 at 131.

9. Manual, § 6.2.2 at 132.

10. Manual, § 6.2.2 at 133.

11. Manual, § 6.1.1 at 125 (17 C.F.R. § 202.12(b)(1)(i)).

12. Manual, § 6.2.2 at 130.

13. Manual, § 6.2.1 at 128.

14. Manual, § 6.2.1 at 129.

15. Manual, § 6.2.1 at 128-29.

16. Manual, § 6.1.1 at 124 (17 C.F.R. § 202.12(a)(2)(i)).

17. Manual, § 6.1.1 at 126-27 (17 C.F.R. §§ 202.12(c)(5), (d)(3)).

18. Manual, § 6.2.4 at 136.

19. Manual, § 6.2.1.

20. Manual, § 6.2.4 at 136.

21. Manual, § 6.2.5 at 137-38.

22. Manual, § 6.2.5 at 138.

23. Manual, § 6.2.5 at 139.

24. Manual, § 6.2.3 at 133.

25. Manual, § 6.2.3 at 135.

26. Manual, § 6.2.3 at 135.

27. Manual, § 6.1.1 at 124-25 (17 C.F.R. § 202.12(a)).

28. The "substantial assistance" language is borrowed from Section 5K1.1 of the Federal Sentencing Guidelines. *See* U.S. Sentencing Guidelines Manual § 5K1.1 (2009).

29. The "acceptance of responsibility" language is borrowed from Section 3E1.1 of the Federal Sentencing Guidelines. *See* U.S. Sentencing Guidelines Manual § 3E1.1 (2009).

30. Manual, § 6.1.1 at 126 (17 C.F.R. § 202.12(d)).

31. Manual, § 6.1.1 at 125-26 (17 C.F.R. § 202.12(c)).

32. Manual, § 6.1.1 at 127 (17 C.F.R. § 202.12, note).

33. Manual, § 6.1.1 at 127 (17 C.F.R. § 202.12, note).

34. Manual, § 6.3 at 140.

35. Manual, §§ 6.2.2 at 133; 6.3 at 140.

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